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Mozambique's fishy \$850m bond issue doubles its naval forces

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With rates at historic lows, investors are trading transparency for higher payouts, write Boris Korby, Paul Burkhardt and Lyubov Pronina

THE deal that helped one of the poorest nations raise \$850m and bond investors lock in rates three times higher than US Treasuries is also spurring concern that some money is not going where buyers — and one underwriter — have expected it to go.

Two months ago, Credit Suisse Group and VTB Capital financed a flotilla of tuna boats for Mozambique, then packaged the debt into notes for overseas investors. It turns out the fleet also includes anti-pirate patrol boats, according to the French foreign trade ministry.

The boats are capable of being equipped with 20mm cannons and military drones, according to Stratfor, a global security advisory firm. Credit Suisse is adamant its funding was not used for armed boats.

"The documents mentioned only fishing boats and some training costs," said Marco Ruijter, who helps to oversee about \$8bn in emerging-market bonds at ING Investment Management in The Hague and bought a piece of the debt from VTB Capital because the investment promised such high returns. The notes are backed by the African country, which is developing deposits of coal and gas.

As central banks keep interest rates at historic lows, investors are trading transparency for higher payouts. Tanzania, with an unrated \$600m private deal, and Angola, with a \$1bn transaction structured in a similar way to Mozambique's, also made debuts in the international debt market in the last 15 months without disclosing details that buyers of lower-paying Eurobonds would require.

Mozambique's maiden voyage in international debt markets involved the government setting up Empresa Moçambicana de Atum, or Mozambican Tuna, in August. By September 27, the company had secured loans from Credit Suisse and Moscow-based VTB Capital for a combined \$850m — equal to 6% of everything produced in the country last year.

The banks sliced the loans into smaller chunks and marketed the loan participation notes to investors to fund "fishing infrastructure", according to the prospectuses. The securities are not listed on any exchange.

Mozambican Tuna, called EMATUM in loan documents, borrowed \$500m from Credit Suisse and \$350m from VTB Capital without meeting money managers or listing the names of the firm's directors before the sale. There was no legal requirement that they do so.

Moody's Investors Service rated the loan participation notes B1, four levels below investment grade. The notes, which mature in 2020, were priced to yield 8.5%, about six percentage points more than Treasuries.

The Credit Suisse and VTB Capital prospectuses say that EMATUM would also use the money for "general corporate purposes". At no time has Credit Suisse provided financing to Mozambique, any entity there or elsewhere that includes the procurement of weapons.

The borrowers and boat contractors had confirmed to Credit Suisse that "there are no weapons or combat systems of any kind on any of the vessels being built under the EMATUM contract", said Adam Bradbery, a spokesman in London for the Zurich-based bank.

Makram Abboud, VTB Capital's CEO for the Middle East and Africa, said part of the infrastructure referred to in the VTB prospectus was protection for the fishing boats. "This is for fishing boats, for training centres, for spare parts and for patrol boats to protect fishing business and waters of Mozambique.

"We have always said it's infrastructure to support the fishing industry. That means all infrastructure to reduce

the risk of the boats being taken over by pirates the next day or stolen."

The Mozambique firm was paying €200m for 24 tuna boats and six patrol vessels from Cherbourg, France-based Constructions Mécaniques de Normandie, known as CMN, French foreign trade ministry spokeswoman Perrine Duglet said.

Mozambican Defence Minister Filipe Nhussi said a private security company would manage the patrols.

Credit Suisse and VTB Capital representatives declined to comment on where the rest of the loan money would go. They also declined to disclose fees earned from the transactions. Officials from CMN and its parent company, Abu Dhabi Mar LLC, declined to comment.

Some government officials find the disclosure process for Eurobonds too expensive and time-consuming, said Lee Buchheit, a partner at Cleary Gottlieb Steen & Hamilton in New York. For a sovereign that arranged a loan with a bank or group of banks, the level of disclosure "is often minimal".

Zambia, which sold \$750m of debt in its debut Eurobond sale last year, included in the offering circular more than 50 pages of information on everything from the state of public finances to its monetary system to foreign trade. In the VTB and Credit Suisse prospectuses for the tuna company's loan participation notes, there were three pages on EMATUM and none concerning Mozambique.

"The degree of investor scrutiny, the degree of due diligence that's undertaken for a Eurobond is significantly higher," said Colin Waugh, founder of SCP Africa, a research and advisory firm based in Maputo. "There's very little transparency here."

The six new patrol boats would be double the size of Mozambique's Navy, which consists of three harbour control vessels and 200 sailors, according to Texas-based Stratfor.

The boats on order include three Ocean Eagle 43 models and three HSI 32 interceptors manufactured by CMN, according to Ms Duglet of the French foreign trade ministry. The Ocean Eagle 43 can be fitted with 20mm or 30mm cannons, two machine guns with 360-degree coverage and a landing area for drone aircraft, says Stratfor.

Ms Duglet said she did not know whether the vessels would come equipped with weapons, be fitted with weapons later or be free of weapons.

"I don't really pay attention, even when the government says they're raising funds to do X, Y and Z with it," said Antoon de Klerk of Investec Asset Management in London, who did not buy any of the EMATUM notes. "In terms of the actual structure, at the end of the day all you need is a sovereign guarantee, right?"

While the World Bank says Mozambique has doubled its literacy rate and cut its infant mortality rate by about two-thirds since its 1975 independence from Portugal, its 25.2-million people remain among the poorest on earth. The nation ranks 185th out of 187 in the United Nations human development index this year.

That may change. Mozambique is the site of the world's largest discovery of natural gas in the past decade. Anadarko Petroleum and Eni are developing a liquefied natural gas plant that is targeted to start production in 2018.

Vale, the Rio de Janeiro-based company that is the world's biggest iron-ore producer, is building a railway line through Malawi to the port of Nacala.

Mozambique is targeting coal output of 100-million tonnes by 2020, Mineral Resources Minister Esperanca Bias told a February conference in Cape Town.

Mozambique's degree of disclosure in loan documents was enough to justify investing in the country before its possible commodities boom, said Stephen Bailey-Smith, the head of African Strategy at Standard Bank in London. "We have been recommending clients get involved as we like the longer-term structural story around aluminium, coal, gas and tourism," Mr Bailey-Smith said by e-mail.

The country's economy grew 7.5% last year and will expand 7% this year, according to the International Monetary Fund. That compares with world economic growth of 2.9%.

In 2009, President Armando Guebuza won a second term in office and his Frelimo party extended its rule in landslide victories. Frelimo has governed since leading the country to independence and faces another national election next year.

Since April, clashes between government troops and rebel fighters from dissident force turned opposition party Renamo have intensified. The groups fought a 17-year civil war until signing a peace pact in 1992. Renamo said the peace agreement was over after a October 21 government attack on its base.

Renamo has no seagoing capability, and Mozambique has relied on South African vessels to patrol its waters for pirates, said Mark Schroeder, vice-president of Africa Analysis for Stratfor. Now that Mozambique had "a tremendous economic interest to explore and develop resources such as natural gas, they can't outsource their maritime security to another country".

EMATUM's boats would patrol an ocean bordered by wide sand beaches dotted with palms, in water where algae glows in the dark. Maputo is bustling, while shantytowns line the road to the airport, highlighting the economic disparity between urban and rural areas. More than half of Mozambicans survive on less than 50 US cents a day, according to Lisa Kurbiel, a policy specialist with Unicef in Mozambique.

For investors, the yields on notes for Mozambique and other African nations may be multiples of those for developed nations. For example, the US Federal Reserve has kept its overnight bank lending rate near zero since December 2008.

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